Statement

of David Huether
Chief Economist
National Association of Manufacturers

on behalf of the National Association of Manufacturers

before the **Energy and Commerce**
Commerce, Trade and Consumer Protection Subcommittee

on **"The Commerce and Consumer Protection Implications of Hurricane Katrina"**

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Good morning Chairman Stearns, Ranking Member Schakowsky, and members of the Subcommittee. Thank you for the opportunity to discuss the economic effects of Hurricane Katrina on manufacturing and the economy.

My name is David Huether and I am the Chief Economist at the National Association of Manufacturers (NAM), the nation's largest industry trade association, representing small and large manufacturers in every industrial sector and in all 50 states.

By far, Hurricane Katrina is the biggest natural disaster in the U.S. in recent memory. In addition to the terrible loss of life, Hurricane Katrina hit the Gulf Coast at a time when energy prices were already surging. Katrina's impact on the energy-intensive region created an additional energy-price shock to the nation. As a result, the economic effects of Katrina will not be "lost in the rounding", as has occurred with some past natural disasters.

Importance of the Gulf Coast to the Economy

Collectively, the economies of Alabama, Louisiana, and Mississippi (the states hardest hit by Hurricane Katrina) totaled $367 billion in 2004[1], roughly the size of Michigan, or about 3.1 percent of the overall U.S. economy, and 3.4 percent of our nation's overall manufacturing output. Manufacturing is the largest private sector in Mississippi and Alabama, where it accounts for 16% of the economy in both sates, and the second-largest industry in Louisiana, where manufacturing accounts for 11 percent of the state economy.

The New Orleans Customs District is the gateway to the global economy for much of the middle of the country. Much of this international trade comprises of commodity and agricultural products. Fully a quarter of U.S. agricultural exports, including 62 percent of corn and soybean exports, travel through this region to markets around the world. At the same time, more than 20 percent of iron & steel, fertilizer and ore imports enter our economy through the ports of the Gulf Coast.

[1] U.S. Department of Commerce, Bureau of Economic Analysis

Overall, 5 percent of U.S. manufactured exports to the world are channeled through the New Orleans Customs District; while close to 4 percent of manufactured imports enter our economy through these ports.

Most of the Gulf Coast ports escaped the hurricane with minimal damage. Based on assessments by the Louisiana Department of Transportation and Development, two of the six deepwater ports located in Louisiana suffered extensive damage: St. Bernard and Plaquemines. The Port of South Louisiana, the nation's largest port by tonnage and essential to the nation's agricultural trade, suffered only minor damage. All of the state's 21 inland and shallow water river ports remain fully operational. Elsewhere along the gulf coast, while the ports of Gulfport, and Bayou La Batre, remain closed, most of the others are operational. While further work needs to be done to replace damaged equipment and restore electricity, the overall effect on international trade flows from Hurricane Katrina will likely be modest and temporary.

Perhaps the largest macroeconomic effect from Hurricane Katrina has been the storm's impact the nation's energy infrastructure. The Gulf of Mexico supplies 29 percent of our nation's domestic oil production and 19 percent of the domestic gas production. [2]

In total, Hurricane Katrina destroyed 37 energy platforms, representing 1 percent of oil and gas production. In addition, 50 platforms were damaged extensively, 4 of which account for 10 percent U.S. production. Current estimates are that it will take between three and six months to make repairs. In addition, four refineries remain shut down, and expectations are that these refineries, which represent about 5 percent of total U.S. refining capacity, could remain idle for an extended period. In summary, while progress has been made over the past few weeks, downstream effects from reduced refining and production capacity will be felt for months.

The Economic Situation Pre-Katrina

Prior to Hurricane Katrina making landfall on August 29, 2005 as an extremely dangerous Category 4 storm, the U.S. economy and the manufacturing sector were growing at a solid pace. Supported by 3.8 percent growth in consumer spending; 9.1 percent growth in business investment; and export growth (8.3%) outpacing import growth (5.9%), the U.S. economy has grown by a solid 3.6 percent in the past year. [3] Manufacturing output increased by a similar 3.3 percent. At the same time, the economy created 2.2 million jobs, and the unemployment rate fell to 4.9 percent – the lowest level in four years.

[2] Minerals Management Service, Department of the Interior
[3] Second quarter of 2004 to the second quarter of 2005. Source: U.S. Department of Commerce

Despite a pre-Katrina increase in energy prices, core consumer inflation, which excludes food and energy, edged up just 1.9 percent over the prior 4 quarters. [4]

More recently, core (non-motor vehicles) retail sales remained solid in July and August, while manufacturing production was beginning to accelerate from a "soft" second quarter. Overall, the economy was on track to grow by 4.3 percent in the third quarter and manufacturing production was expected to accelerate to 5 percent growth by the fourth quarter.

Katrina's Impact on Manufacturers

Hurricane Katrina took a staggering human toll and will also leave a deep, though not permanent impression on the nation's economy as well. In the weeks following Hurricane Katrina, the NAM surveyed its membership to gauge the impact of the storm and its aftermath on manufacturing. While the survey did not likely get through to many companies in the areas most affected by the storm, the responses nevertheless provide a preliminary estimate of the impact of Hurricane Katrina on the broader manufacturing sector. The results are listed below:

16 percent of survey respondents have operations in the areas directly impacted by Katrina. 8 percent have facilities that sustained damage while 10 percent have had production capacity reduced. Of these, 8 percent expect to have production back in a matter of weeks while just 2 percent report that it will take months to resume production.

36 percent have experienced supply disruptions from Hurricane Katrina. 12 percent have experienced just energy supply disruptions and 24 percent have experienced both energy and material input supply disruptions.

28 percent say supply disruptions have affected production. 23 percent have reduced production operations and 5 percent have had to stop production operations due to supply disruptions.

25 percent responded that supply disruptions have caused shortages that have lead to higher prices. 7 percent report energy shortages and 18 percent report shortages in energy and material inputs.

32 percent responded that damage caused by Hurricane Katrina has affected their company's ability to ship products to customers. 26 percent report that shipments have been partially halted, while 6 percent have had shipments completely halted.

84 percent responded that their companies' employees have not been affected (relocated) due to Hurricane Katrina.

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[4] PCE price index excluding food and energy. Bureau of Economic Analysis. U.S. Department of Commerce.

92 percent responded that they will not have to reduce employment due to disruptions from Hurricane Katrina.

Over three quarters (79%) are providing relief assistance. 46 percent are offering a direct money gift; 34 percent have set up an employee matching gift program and 31 percent are donating in-kind relief supplies.

These results indicate that a sizable minority of manufacturing output was directly impacted by Hurricane Katrina's destructive force either directly (10%) or through supply disruptions (28%). However, these impacts appear to be short term. The same will likely go for the quarter of respondents who reported higher prices, depending on how quickly energy production and port operations are reconstituted. Therefore, there will likely be a significant slowdown in manufacturing production in the third quarter along with acceleration in producer prices.

Separately, conversations with businesses in both Mississippi and Louisiana highlighted other concerns not covered in the NAM survey. In addition to damage to plant and equipment, an equally significant problem for manufacturers is the state of their workforce. Hurricane Katrina displaced thousands of workers and also temporarily cut off services such as day care that are used extensively in today's economy. This is making it difficult in some cases for companies to bring production back on line. In addition, because electricity remains out in some rural areas, some employers and employees are having a difficult time communicating. While this is likely a temporary problem, it nonetheless will delay industrial output in some of the harder hit counties and parishes.

Economic Effects of Hurricane Katrina

While not expected to reduce the economy's long-run growth path, Hurricane Katrina, along with the recovery efforts, will have a significant impact on the economy over the next year.

Though the economic effects of Katrina have devastated the Gulf Coast, the overall impact on the U.S. economy is expected to be a significant (26%) slowdown in the pace of economic growth in third quarter and a more-modest negative effect in the fourth quarter, followed by an acceleration in economic growth in the first half of 2006 compared to pre-Katrina outlook as reconstruction efforts begin in earnest. (See Table 1 below.)

Preliminary Estimates of Economic Damage from Hurricane Katrina. Based on preliminary analysis, the extent of damage to residential and business capital stock totaled $71 billion, 70 percent of which was residential housing and personal property. Much of the remaining loss was oil and natural gas production facilities and refining capacity.

Expected futures prices of gasoline for September rose 36 percent, based on fears that a significant amount of damaged energy plants and equipment would remain off-line for a long time. However, significant progress had already been made.

At the peak of the hurricane on August 30th, 95 percent of daily oil production in the gulf and 88 percent of daily gas production was "shut in". These numbers have been drastically reduced. By September 16th, just over half (56%) of oil production remained shut in (most due to problems with onshore infrastructure) and just a third of natural gas production remained off-line. While tight energy supplies will continue going forward, concerns that energy prices, particularly oil and gasoline, will remain at their immediate post-Katrina levels have thankfully not proved to be accurate, evidenced by the fact that futures prices for gasoline have fallen by 22 percent since late August and prices at the pump have also begun to moderate.

Still, the loss of energy production has been significant. Moreover, the rise in energy prices in the wake of the hurricane will have a sizable impact on consumer spending, since gasoline purchases alone account for close to 3 percent of consumer purchases.

The loss of production in other areas of the economy from displaced workers, estimated at over 300,000, will further cut into economic growth in the second half of the year.

While the destruction caused by Hurricane Katrina will slow GDP growth significantly in the second half of this year (see detail below), the recovery efforts, some of which are underway but most of which are still being conceptualized, will have a positive effect on the economy. For example, rebuilding residential capital destroyed by the hurricane could require upwards of 50,000 single family starts and 10,000 multifamily starts by mid-year 2006.

Economic Outlook Post-Katrina. Hurricane Katrina is expected to slow economic growth by more than a percentage point to 3.2 percent growth in the third quarter. This is 26 percent slower than the 4.3 percent pace assumed in the pre-Katrina scenario (see Table 1.)[5] Similarly modest (3.3%) economic growth is expected in the fourth quarter as well.

Much of the slowdown comes from a 19 percent reduction in the growth rate for consumer spending which accounts for 70 percent of the economy. The displacement of hundreds of thousands of residents of Gulf Coast states as well as higher energy prices (which lowers consumers' disposable incomes) will cut deeply into consumer spending in September (the last month of the third quarter) and later in the fourth quarter. Instead of rising by 4.3 percent, consumer spending will increase by 3.5 percent in the third quarter. While this sounds optimistic, it must be put in the context that consumer spending increased by close to a 9 percent annual rate in July. In the fourth quarter, consumer spending is expected to increase by just 2.4 percent.

Growth in capital spending by businesses is expected to slow by 50 percent in the third quarter and increase by just 3.9 percent, the slowest pace since the first quarter of 2003. Later in the fourth quarter, the pace of business investment will accelerate and grow by 6.6 percent as the rebuilding of damaged infrastructure begins.

[5] SAAR (Seasonally Adjusted Annual Rate). Based on NAM projections using the Washington University Macro Model.

From the slowdown in both consumer spending and business investment, manufacturing output will increase by just 3.1 percent in the second half -- 40 percent slower than the 5.1 percent pre-Katrina baseline.

The CPI will likely increase by close to 6 percent in the third quarter as result of higher energy prices. However, as supply comes back on line, the inflation rate is expected to slow to 2.7 percent in the 4th quarter and rise just 2 percent in 2006.

Anticipated reconstruction efforts in the fist half of 2006 (particularly in the first quarter) and moderating energy prices will create a see-saw effect for the economy and for manufacturing, both of which will not only accelerate, but grow faster than in the pre-Katrina scenario.

GDP is expected to increase by 4.1 percent in the first half of 2006, or 28 percent faster than the pre-Katrina baseline. At the same time, manufacturing production will increase by close to 6 percent during the first six months of next year before slowing to more modest growth later in the year. In summary, while job dislocations and damaged production capacity will steer the economy into troubled waters in the months ahead, faster quickening growth and job creation will make for smoother sailing next year.

Table 1: Economic Impact of Hurricane Katrina

Percent Change (annual rate)

		2005.3	2005.4	2006.1	2006.2	2005 (2nd Half)	2006 (1st Half)
GDP	Pre Katrina	4.3	3.6	3.2	3.2	4.0	3.2
	Post Katrina	***3.2***	***3.3***	***4.4***	***3.8***	3.3	4.1
	Difference	-1.1	-0.3	1.2	0.6	-0.7	0.9
	Percent difference	*-26%*	*-8%*	*38%*	*19%*	*-18%*	*28%*
Personal Consumption	Pre Katrina	4.3	2.4	3.5	3.4	3.4	3.5
	Post Katrina	***3.5***	***2.4***	***4.1***	***3.5***	3.0	3.8
	Difference	-0.8	0	0.6	0.1	-0.4	0.4
	Percent difference	*-19%*	*0%*	*17%*	*3%*	*-12%*	*10%*
Business Investment	Pre Katrina	8.5	4.5	8	8.6	6.5	8.3
	Post Katrina	***3.9***	***6.6***	***9.8***	***9***	5.3	9.4
	Difference	-4.6	2.1	1.8	0.4	-1.3	1.1
	Percent difference	*-54%*	*47%*	*23%*	*5%*	*-19%*	*13%*
		2005.3	2005.4	2006.1	2006.2		
Manuacturing Output	Pre Katrina	4.5	5.8	5.4	5.2	5.2	5.3
	Post Katria	***3***	***3.2***	***5.5***	***5.9***	3.1	5.7
	Difference	-1.5	-2.6	0.1	0.7	-2.1	0.4
	Percent difference	*-33%*	*-45%*	*2%*	*13%*	*-40%*	*8%*

Source: National Association of Manufacturers
Based on the Washington University Macro Model, Macroeconomic Advisors